

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2019-233-A

IN RE: Procedure to Address Treatment of Deferrals) **SOUTH CAROLINA OFFICE**
 (See Page Number 5 of Order No. 2019-341)) **OF REGULATORY STAFF**
) **COMMENTS**

The below comments are provided to the Public Service Commission of South Carolina (“Commission”) by the Office of Regulatory Staff (“ORS”) in response to Commission Order No. 2019-477, which requested comments by the public and any interested parties by Friday, September 6, 2019. This docket was opened to comply with Commission Order No. 2019-341 in Docket No. 2018-318-E, in which the Commission directed the establishment of an administrative docket regarding the creation and treatment of deferrals. ORS appreciates the opportunity to provide comments.

ORS recommends the Commission enter an Order in this docket that provides interested parties general policy guidance, while ensuring the Commission has the ability to evaluate each request for an accounting order using its expertise and remains free to exercise discretion. ORS believes that utilities should be allowed to use deferral accounting as a tool in limited situations where the utility demonstrates in a clear and convincing manner that (1) the costs in question are unusual or extraordinary in nature and (2) absent deferral, the costs would have a material impact on the utility’s financial condition.

This Commission has the exclusive “power and jurisdiction to supervise and regulate the rates and service of every public utility in this State and to fix just and reasonable standards, classifications, regulations, practices, and measurement of service to be furnished, imposed or

observed, and followed by every public utility in this State.” S.C. Code Ann. §58-3-140 (2015). It is within this authority that the Commission can adopt policies, guidelines and/or promulgate regulations that permit utilities under the Commission’s jurisdiction to pass the costs of certain operating expenses to the customers.

In exercising its power, the Commission may follow the process set forth under the Administrative Procedures Act (“APA”) and promulgate a regulation *or* issue a general policy statement or guidance. A general policy statement or guidance lacks the force and effect of a regulation. Whether the Commission should promulgate a regulation or simply issue a general policy statement depends on whether the standard establishes a binding norm. In determining whether a binding norm has been established, the “key inquiry” is,

the extent to which the challenged policy leaves the agency free to exercise its discretion to follow or not to follow that general policy in an individual case, or on the other hand, whether the policy so fills out the statutory scheme that upon application one need only determine whether a given case is within the rule's criterion. As long as the agency remains free to consider the individual facts in the various cases that arise, then the agency action in question has not established a binding norm.

Joseph v. S.C. Dep't of Labor, Licensing & Regulation, 417 S.C. 436, 454, 790 S.E.2d 763, 772 (2016) (quoting *Home Health Serv., Inc. v. S.C. Tax Com'n*, 312 S.C. at 329, 440 S.E.2d at 378; *Sloan v. Sanford*, 357 S.C. 431, 491, 593 S.E.2d 470, 598 (2004) (Toal, C.J., dissenting)).

It is ORS’s responsibility to make inspections, audits and examinations of public utilities on matters within the Commissions jurisdiction. ORS’s comments in this Docket are offered to assist the Commission to adopt policies or guidelines, which provide utilities and other interested parties guidance but allow the Commission the ability to evaluate each request for an accounting order using its expertise and remain free to exercise its discretion. ORS believes its comments would:

- (1) Promote efficient use of Commission resources by providing a framework to assess deferral requests;
- (2) Streamline the inspection, audit and examination of public utilities;
- (3) Enhance transparency of the utility rates and services;
- (4) Ensure continued utility investment facilities to provide high-quality and reliable utility service; and
- (5) Mitigate the risk to utility customers.

1. General Information and Discussion of Regulatory Deferrals and Accounting Orders

One of the principles of utility ratemaking is to match revenues and expenses. Commission Regulation 103-823(A)(3) requires a utility to use a historic twelve-month test period unless otherwise directed by the Commission. A utility reaps the benefit and bears the burden of cost decreases or increases between rate cases. A utility may not amortize and collect prior losses in current rates because retroactive ratemaking is prohibited under South Carolina law. “Retroactive rate-making is prohibited based on the general principle that those customers who use the service provided by the utility should pay for its production rather than requiring future rate payers to pay for past use.” *Porter v. South Carolina Pub. Serv. Comm’n*, 328 S.C. 222, 231, 493 S.E.2d 92, 97 (1997) (citing *Popowsky v. Pa. Pub. Util. Comm’n*, 164 Pa. Comwlth., 338, 642 A.2d 648 (1994)).

However, utilities may seek an accounting order, which can be used as a tool to defer costs that would otherwise be expensed in accordance with Generally Accepted Accounting Principles (“GAAP”). See *In re Arizona Public Service Co.*, 239 P.U.R.4th 1, 16 (Ariz. Corp. Comm’n 2005). According to the Financial Accounting Standards Board (“FASB”), a regulated utility may defer costs if:

- (1) It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for ratemaking purposes; and
- (2) The future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs.¹

Typically, a Commission's approval of an accounting order does not immediately affect rates or charges and has no precedential effect on the Commission's ratemaking treatment of the balance deferred. The use of an accounting order to defer costs or revenues moves the recognition of those costs or revenues from a historic period to a future period. This creates an exception to Commission Regulation 103-823(A)(3) and allows costs and revenues incurred outside of the historic test period to be considered in setting future rates. In the presence of an accounting order, the recording of amounts as Regulatory Assets or Regulatory Liabilities avoids concerns about retroactive ratemaking. *See Citizens Utilities Co. of Ill. Application for an Order Approving Deferred Accounting for Year 2000 Compliance Costs*, No. 98-0895, 2000 WL 34446581 (Ill. Commerce Comm'n March 15, 2000).

2. Generally Accepted Standards for Approval of a Regulatory Asset or Liability via an Accounting Order

A deferral of costs is only warranted where an event affecting the utility's costs or revenues is *unusual or extraordinary*. *See, supra, Porter*, 328 S.C. 222, 231 (citing *Popowsky*, 642 A.2d 648, and *Stewart v. Utah Pub. Serv. Comm'n*, 885 P.2d 759 (Utah 1994)). Changes in revenues, expenses, and investments occur routinely between the time a utility's rates are fixed by the Commission and the time of the next rate case. These routine changes alone do not change the balance of revenues, expenses, and investments established in the Commission's last rate order. In

¹See FASB (Financial Accounting Standards Board). (n.d.). ASC 980-340-25-1. *Accounting standards codification*. Retrieved from <https://asc.fasb.org/section&trid=2156667>

other jurisdictions, it is a general standard that only unusual or extraordinary expenses should warrant consideration of special regulatory accounting treatment. These unusual or extraordinary expenses should also be nonrecurring in nature and unexpected in the normal course of business operations. Recurring and expected expenses should be handled through utility base rates.

The North Carolina Utilities Commission (“NCUC”) employs a two-part test to determine whether the use of deferral accounting treatment is required:

- (1) whether the costs in question are unusual or extraordinary in nature; and
- (2) whether, absent deferral, the costs would have a material impact on the utility’s financial condition.²

Similar standards are used by other state Commissions, such as the Minnesota Public Utility Commission, Montana Public Service Commission, Connecticut Public Utilities Regulatory Authority, and the New York Public Service Commission. Events that have justified the use of deferral accounting treatment in the past include significant storm restoration and repair costs or construction of significant generating capacity.

As the two-part test above requires, in the consideration of special regulatory treatment, such as the establishment of a regulatory asset, the Commission must consider not only whether the expense is unusual or extraordinary, but also whether the expense incurred by the utility would have a **material** impact on the utility’s financial condition. The utility bears the burden to demonstrate that the costs would have a material impact on the utility’s financial condition absent deferral accounting treatment. The costs should be considered in totality to determine if the costs are materially significant in consideration of the utility’s current level of earnings. For instance,

² See North Carolina Utilities Commission Docket No. E-22, Sub. 519 Order issued on March 29, 2019, in which the NCUC quoted Dominion North Carolina Power as stating, “the [NCUC] has applied a well-established standard, which considers (1) whether the costs in question are unusual or extraordinary in nature; and (2) whether, absent deferral, the costs would have a material impact on the Company’s financial condition.”

the New York Public Service Commission and the NCUC determined that an item representing more than 5% of a utility's income is generally considered to be extraordinary or material.³ This definition is further supported by the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts.⁴ When determining impact on the financial condition a Commission should consider the potential impact of the present costs on the utility's future level of earnings, absent approval of the deferral request; current economic conditions; and the utility's currently authorized return on equity.

3. Expenses Eligible for Deferral Accounting Treatment

Pursuant to the two-part test, Deferral accounting treatment should not be granted for estimated expenses or contingency amounts. Examples of eligible incurred costs categories include, but are not limited to, depreciation, property taxes, and non-fuel related operation and maintenance expenses. A utility should not be allowed to accrue carrying costs on the deferral balance or accrue a deferred return associated with capital expenditures because the carrying cost and deferred return are not an incurred cost of the utility.

The deferred account should also include any actual savings associated with the extraordinary or unusual incurred expenditure. For example, if the utility realizes savings from deployment of advanced metering infrastructure during the pendency of the deferral of expenses, those savings should be recorded and used to reduce the deferral balance.

A. Prudence of Deferral Account Expenses

³ *In the Matter of Application by Virginia Elec. & Power Co., d/b/a Dominion N. Carolina Power, for Approval of Amended Schedule Ns, No. E-22*, 2016 WL 1295161, at *10 (Mar. 29, 2016) ("[w]ith respect to deferral accounting, under the guidance of the Uniform System of Accounts adopted by this Commission for electric utilities, unless the Commission decides otherwise, an item representing more than 5% percent of a utility's income is generally considered to be extraordinary.") (citing 18 CFR Pt. 1 101); *Petition of Orange & Rockland Utilities, Inc. for Authorization to Defer Incremental Costs*, No. 08-M-1299, 2009 WL 5889922 (NYPSC Dec. 17, 2009).

⁴ 18 CFR Pt. 101, FERC Uniform System of Accounts, General Instruction 7, Extraordinary Items.

Approval of an accounting order should be limited to approval for accounting purposes. The approval of an accounting order should not be a determinative as to the proper accounting treatment, an approval of the incurred expenses, or approval of any underlying assumptions made by the utility when it incurred the expenses. Further, the issuance of an accounting order should not predetermine the prudence of the costs incurred by the utility or preclude the Commission, ORS, or any other party from addressing the reasonableness of the incurred costs associated with the approved accounting order in a subsequent general rate case or other proceeding. A full review of the costs incurred under an accounting order should occur in the context of a general rate proceeding.

B. Determination of Specified Time Period for Deferral Account and Amortization Period

The time period for the deferred accounting treatment should be established in the accounting order to limit the growth of the deferred account. In addition, a date should be established by which the utility should begin amortization such that the balance of the deferred costs is not recorded on its books without amortization for an unspecified period. For example, NCUC requires amortization for storm restoration and repair costs to begin in the month the storm occurs.⁵

In the next general rate case, after the deferral account expenses have been reviewed for prudence, the amortization period for the deferred balance should be determined in the context of the general rate case proceeding. Further, in the event the utility recovers deferred expenses for a period beyond the granted amortization period, the utility should record the additional revenue to the same deferral account such that it would be returned to customers. This would protect the

⁵ See NCUC Docket No. E-2, Sub 1193.

customers and prevent the utility from receiving a windfall in situations where the utility continued to recover expenses over the amount necessary to fully recover the utility's incurred costs.

4. Accounting and Reporting Recommendations

In order to monitor the deferred account, ORS recommends the utility file quarterly reports with the Commission and ORS. The reports should include, at a minimum, the following information: 1) deferred expenses by type, 2) commission docket and order number authorizing the deferral, 3) current balance of deferral, 4) previous quarterly's balance, 5) change from previous quarterly balance, 6) approved amortization amount, 7) original amortization period, and 8) remaining amortization period.

ORS Recommendations

In keeping with other state Commissions, the ORS recommends this Commission adopt policies or guidelines, which provide utilities and other interested parties guidance, but are not binding, and allow the Commission to evaluate each request for an accounting order using its expertise and free to exercise discretion. ORS believes that utilities should be allowed to use deferral accounting as a tool in limited situations where the utility demonstrates in a clear and convincing manner that (1) the costs in question are unusual or extraordinary in nature and (2) absent deferral, the costs would have a material impact on the utility's financial condition. Deferral accounting treatment should be used sparingly and as an exception to Commission Regulation 103-823(A)(3).

ORS appreciates the Commission's interest in the issues surrounding deferral accounting treatment for utilities. The recommendation by ORS to establish policies or guidelines provides utilities under the Commission's jurisdiction with guidance on appropriate situations for the consideration of deferred accounting treatment, would streamline the inspection, audit and

examination of public utilities; enhance transparency of the utility rates and services; ensure continued utility investment facilities to provide high-quality and reliable utility service; and mitigate the risk to utility customers. Should the Commission require additional information or comment, ORS is willing to provide such either in writing or at oral argument before the Commission.



Andrew M. Bateman, Esquire
OFFICE OF REGULATORY STAFF
1401 Main Street, Suite 900
Columbia, South Carolina 29201
Phone: (803) 737-8440
Fax: (803) 737-0895
E-mail: abateman@ors.sc.gov

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